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In the Supreme Court of the United States

OCTOBER TERM, 1959

SMALL BUSINESS ADMINISTRATION, PETITIONER

v.

G. M. McCLELLAN, TRUSTEE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Solicitor General,
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CITATIONS

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The Solicitor General, on behalf of the Small Business Administration and the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in this case on November 6, 1959.

OPINIONS BELOW

The opinion of the United States District Court for the District of Kansas (R. 40)[1] is reported at 168 F. Supp. 483. The opinion of the court of appeals (App., *infra,* pp. 23–28) is reported at 272 F. 2d 143.

JURISDICTION

The judgment of the court of appeals was entered on November 6, 1959 (App., *infra,* p. 29). On Jan-

[1] All record references are to the pages of the "Transcript of Record" printed for the use of the court of appeals and filed here pursuant to Rule 21 of this Court.

uary 25, 1960, Mr. Justice Whittaker extended the time to file a petition for a writ of certiorari to and including February 24, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, where an agency of the United States participates with a private financial institution in making a loan, the agency must be denied the debt priority granted the United States by R.S. § 3466 solely because, by virtue of the participation agreement between the two, the financial institution will share ratably in any amounts recovered on the loan by the Government agency.[2]

STATUTES INVOLVED

1. Section 64 of the Bankruptcy Act, as amended, 11 U.S.C. 104, provides in pertinent part:

§ 104. *Debts which have priority.*

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (5) debts owing to any person, including the United

[2] In the event that certiorari should be granted, the Government would ask the Court to decide, in addition to the question presented in this petition, the other important issues expressly left undecided by the court below (App., *infra*, pp. 23–28): (1) whether debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. § 3466, and (2) whether, by virtue of its immediate participation in the loan, the S.B.A. became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy.

States, who by the laws of the United States i[s] entitled to priority * * *.

2. Section 3466 of the Revised Statutes, 31 U.S.C. 191, provides:

§ 191. *Priority established.*

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

STATEMENT

This suit was brought by the Small Business Administration, on behalf of the United States, to review the order of a referee in bankruptcy denying the Small Business Administration's claim to priority on a debt owing from the bankrupt.

On October 8, 1956, S. H. Byquist submitted an application for a $20,000 loan to the Brookville State Bank of Brookville, Kansas (R. 17–26). The application was on a Small Business Administration form and was directed primarily to the Small Business Administration ("S.B.A.") (R. 17). The bank endorsed Byquist's application, indicating that it would make the loan requested, but only on condition that

the S.B.A. participate in the loan immediately to the extent of 75 percent, that is, $15,000 (R. 26).

On November 2, 1956, the S.B.A. approved the loan and agreed to participate in it immediately (R. 27–28). A "Participation Agreement" was entered into by the S.B.A. and the Brookville State Bank which provided, *inter alia,* that the S.B.A. would, upon written demand by the bank, purchase from the bank a 75 percent participation of each disbursement made to Byquist (R. 6). It was also provided that the bank would hold the note, but that if the S.B.A. should make a written demand therefor, the bank would transfer the note to the S.B.A. within five days (R. 9). In addition, the agreement contained the following provisions (R. 9–10):

> 12. Administration of Loan.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan * * *.
>
> * * * * *
>
> 14. Liability and Representations.—* * * neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan.

In compliance with this agreement and upon demand of the bank, the S.B.A. sent a check for $15,000, dated November 23, 1956, and drawn on the Treasurer of the United States, to the bank for purchase of a

75 percent interest in the loan to Byquist (R. 16, 30).[3] The bank then loaned Byquist $20,000 (R. 33–34, 42). This loan was evidenced by a note,[4] dated November 16, 1956, to the order of the bank (R. 10–14).

An involuntary petition in bankruptcy was filed with respect to Byquist on August 17, 1957, and he was adjudged a bankrupt on September 5, 1957 (R. 40). On October 22, 1957, a trustee was appointed (R. 40). He proceeded with the liquidation of the estate and holds a sum somewhat in excess of $19,000 (R. 34, 40). Claims totaling $43,682.07 have been filed

[3] Upon receipt of the Government check, the bank executed and delivered to the S.B.A. a participation certificate as evidence of the purchase by the S.B.A. of its interest in the loan. While the executed "Participation Certificate" (S.B.A. form 152) was not in the record before the district court, its execution by the bank is not questioned. The text of the certificate is as follows:

PARTICIPATION CERTIFICATE

BROOKVILLE STATE BANK (hereinafter called "Bank"), hereby certifies that Small Business Administration (hereinafter called "SBA") has purchased from Bank a participation of 75% of $20,000.00, representing the amount of the disbursement, or the aggregate amount of the disbursements (as the case may be) made by Bank on the 23rd day of November 1956, and remaining unpaid on the date of such purchase, on account of a loan by Bank to S. H. Byquist, d/b/a Western Distributors, Salina, Kansas, in an amount not exceeding $20,000.00, such purchase having been made pursuant to a Participation Agreement dated November 19, 1956, between SBA and Bank.

Dated: November 23, 1956

By [S] Brookville State Bank (Bank)
R. D. Powers
Cashier (Title)
Brookville, Kansas (Address)

[4] This note is on another S.B.A. form which is headed "Note (For Limited Loan Participation Only)" (R. 10).

and the cost of administration has been estimated at $6,500.00 by the trustee (R. 34).

Subsequent to the date of Byquist's bankruptcy, the bank assigned his note to the S.B.A. (R. 34). The S.B.A., on behalf of the United States, filed a priority claim in the bankruptcy proceedings under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, p. 2, which provides that "debts owing to any person, including the United States, who by the laws of the United States, i[s] entitled to priority" are accorded fifth priority in bankruptcy. The S.B.A. claimed such priority "by the laws of the United States" over the other unsecured creditors by virtue of R.S. § 3466, 31 U.S.C. 191, *supra*, p. 3, which establishes that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor. The S.B.A. filed a claim for the sum of $16,788.42, representing the entire amount still unpaid on the note, with interest through October 15, 1957 (R. 4). Recognizing, however, that 25 percent of this claim represents an amount owed by the bankrupt to the bank, the Government has, throughout these proceedings, in fact claimed priority only for $12,266.77, its 75 percent interest in the debt (R. 36).[5]

[5] The $12,266.77 sought by the S.B.A., and for which priority is here asserted, represents the extent to which the S.B.A.'s $15,000 participation in the loan remains unpaid. Since the bank's 25 percent interest in the debt was assigned to the S.B.A. subsequent to the date of bankruptcy, this portion of the debt remained, for bankruptcy purposes, a claim of the bank. While the court of appeals' opinion does not indicate that the Government's priority claim was for only $12,266.77, the amount due it, and not for the $16,788.42 owing

The referee in bankruptcy denied the S.B.A.'s claim to priority on the ground that the S.B.A. is not entitled to the debt priority accorded to the United States by R.S. § 3466, 31 U.S.C. 191 (R. 35–38). The claim was allowed only as an unsecured claim (R. 38). On review, the United States District Court for the District of Kansas rejected the referee's conclusion that the S.B.A. could not claim the debt priority accorded to the United States, but, nevertheless, affirmed the referee's order on the ground that there was no debt due the S.B.A. when the petition in bankruptcy was filed (R. 43–45). In support of its decision, the court pointed out, *inter alia,* that the note executed by the bankrupt was made payable to the bank only, that the S.B.A. paid its $15,000 share of the loan to the bank, and that the bank paid the full amount of the loan to the bankrupt (R. 45). Accordingly, the court held that, since under *United States* v. *Marxen,* 307 U.S. 200,[6] the status of a claim against a bankrupt's estate is determined on the date the petition is filed, and since an assignment after that date cannot give an assignee any greater rights than those of his assignor, the S.B.A.'s claim to priority must be denied (R. 45–46).

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on the entire loan, this fact was made clear by the Government throughout the proceedings. The court of appeals failed to make this plain in its opinion presumably because, in view of its reasoning, the amount for which the S.B.A. was claiming priority was irrelevant.

[6] The district court ignored the Government's contention that unlike *Marxen*, the Government became beneficial owner of its interest in the claim prior to the petition in bankruptcy—that is, at the time the federal payment was made to the bank, more than nine months before the petition was filed. See pp. 4–5, *supra.*

On appeal by the United States, the Court of Appeals for the Tenth Circuit affirmed, but on still another ground. The court assumed, *arguendo,* that the Small Business Administration is entitled to the statutory priority granted the United States (App., *infra,* p. 25). Further, it assumed, *arguendo,* that, by virtue of its immediate participation in the loan, the Small Business Administration became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy, thus rendering unimportant the post-bankruptcy assignment of the note (App., *infra,* p. 26). The court ruled that, in any event, the S.B.A. could not assert a priority for the amount owing to it because, in its participation agreement with the bank, it had agreed to share ratably the proceeds and losses resulting from the transaction with the borrower. The court stated (App., *infra,* pp. 27–28):

> In *Nathanson* v. *National Labor Relations Board,* 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.
>
> The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. * * *
>
> * * * * *

> * * * [The United States] may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

REASONS FOR GRANTING THE WRIT

The holding of the court of appeals is, in effect, that whenever an agency of the United States participates with a private financial institution in making a loan, and the participation contract between the two provides for the pro rata sharing of the gains and losses on the transaction, the Government agency must be denied, *in toto*, the debt priority accorded the United States by statute. We submit that this holding misinterprets this Court's decision in *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, and erroneously confines within narrow limits the scope of R.S. § 3466, an important statute designed to protect federal funds. Since the decision below will have far-reaching and severe detrimental effects on extensive Government lending activities, review by this Court is warranted.

The decision has placed not only the S.B.A., but also other Government agencies administering similar programs, in a critical dilemma with respect to whether or not to alter the nature of their participation lending activities. Any modification by them of their participation agreements so as to avoid the impact of the decision below would tend to make private lending institutions unwilling to take part in the Government programs. These extensive and important participation lending programs, explicitly authorized and fostered by Congress, would thus be defeated.

The alternative—letting the participation agreements remain unmodified—would, under the ruling of the Tenth Circuit, result in leaving the vast sums of money which are disbursed by the Government in connection with these programs completely unprotected by any priority right. And, even if all the agencies concerned should modify their future contracts (a course of action which, as indicated above, would be highly undesirable), the Government would still lose its priority right, under the ruling below, with respect to the hundreds of millions of dollars by which it has committed itself pursuant to participation agreements already in effect.

1. R.S. § 3466, granting the United States a priority with respect to debts, was enacted "in order to secure an adequate revenue to sustain the public burdens * * *." *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35; *Price* v. *United States*, 269 U.S. 492, 500; *United States* v. *Emory*, 314 U.S. 423, 426. Accordingly, this Court has repeatedly stated that the statute must be given a liberal construction which will effectuate this purpose. *United States* v. *State Bank of North Carolina, supra; Price* v. *United States, supra; United States* v. *Emory, supra; Bramwell* v. *U.S. Fidelity Co.*, 269 U.S. 483; *United States* v. *Marxen*, 307 U.S. 200.

In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, the Board had ordered an employer to pay certain employees back wages which they had lost because of an unfair labor practice committed by the employer. When the employer went into bankruptcy, the Board asserted priority under R.S. § 3466 for the

amounts due the employees. This Court held that the back-pay claim was not one entitled to priority under R.S. § 3466 since (344 U.S. at 27–28):

> The priority granted by that statute was designed "to secure an adequate revenue to sustain the public burthens and discharge the public debts." See *United States* v. *State Bank*, 6 Pet. 29, 35. There is no function here of assuring the public revenue. The beneficiaries of the claims are private persons * * *.
>
> * * * We cannot extend that reasoning so as to give priority to a claim which the United States is collecting for the benefit of a private party.

We believe it clear that the reasoning of this Court in *Nathanson* is inapplicable to the completely different situation involved in the instant case.[7] In the present case, the United States is *not* asserting its priority so as to collect any amounts owed to private parties, but is merely seeking to recover the precise sum which the transaction with the bankrupt caused to be disbursed from the Treasury and which is still outstanding. Furthermore, in contrast to the *Nathanson* case, 75 percent of the amount recovered here by the United States will actually be returned to the Treasury,[8] thus effectuating the purpose of the priority statute. And, although the remaining 25 percent of the amount recovered by the United States from

[7] The district court agreed with the Government that the *Nathanson* case is inapplicable here, rejecting the contention of the trustee which ultimately became the ground of decision of the court of appeals (R. 44).

[8] In *Nathanson*, of course, 100 percent of the back pay award was to go to the private employees.

the bankrupt will be remitted to the Brookville State Bank, this payment to the bank will occur by virtue of an independent contractual obligation undertaken by the United States and not, as in *Nathanson*, because the sum is owed by the bankrupt directly to the private party. Yet, despite these crucial distinctions, the court below, relying on the *Nathanson* decision, has ruled that the claim of the United States for priority in this case must be denied in its entirety.

The view of the court of appeals that granting the S.B.A. a priority here would give the private bank an undue advantage over the other private creditors is untenable. The bank will recover the same proportion of its claim in the bankruptcy proceeding as the other private creditors. Any additional amounts that it may recover from its advance to the bankrupt will be solely by virtue and because of its agreement with the S.B.A., which is entirely independent of the bankruptcy proceeding. This independent agreement between the S.B.A. and the bank, providing for the sharing of proceeds and losses, cannot properly be considered with respect to the question of whether the S.B.A.'s claim is entitled to statutory priority in the bankruptcy proceeding.

The crucial consideration, we believe, is that, quite apart from its dealings with the bank, the S.B.A. is owed by the bankrupt the $12,266.77 here claimed, an amount which has, in fact, been advanced from the Treasury. Since the S.B.A. is claiming an amount no greater than that owed directly to it, it can be no concern of the private creditors what the S.B.A. does with the sum after collecting it, or what contractual

arrangements it may have with respect to it. These creditors are in no worse position and collect no less if the S.B.A. remits part of its recovery to the bank than would be the case if there were no contract providing therefor and the S.B.A. retained its entire recovery. It is difficult to see, then, by what reasoning the trustee in bankruptcy can be permitted to seize on an independent contractual undertaking of the United States to defeat the United States' claim for priority with respect to a sum to which it is admittedly entitled. The Tenth Circuit's decision produces this paradoxical and erroneous result.

2. In 1953, Congress enacted the Small Business Act, 67 Stat. 232, to implement its view that the security and economic well-being of the Nation requires the development and encouragement of small business enterprises. Sec. 202, 67 Stat. 232; see 72 Stat. 384, 15 U.S.C. 631.[9] The Act created the Small Business Administration, an unincorporated federal agency subject to the direction and supervision of the President and financed by funds originating from congressional appropriations, to carry out the Congressional policies. Sec. 204, 67 Stat. 233; see 15 U.S.C. 633. Among the powers which Congress has granted the S.B.A. was that of making loans to small business concerns, "either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." Sec. 207(a), 67

[9] After several amendments, the Act was reenacted in 1958. 72 Stat. 384, 15 U.S.C. 631–651. All the sections of the 1953 Act which are cited in this petition have been reenacted in virtually identical form in the 1958 Act.

Stat. 236; 15 U.S.C. 636(a). With respect to such loans, the statute prescribed specifically (Section 207(a)(1), 67 Stat. 236; 15 U.S.C. 636(a)(2)):

> [N]o immediate participation may be purchased unless it is shown that a deferred participation is not available;[10] and no loan may be made unless it is shown that a participation is not available * * *.

These restrictions on the S.B.A.'s lending activities were imposed by Congress to effectuate its policy that private lending institutions, and not the Government, should continue to be the principal source of credit for small business. See S. Rep. No. 604, 83d Cong., 1st Sess. 2–3; H. Rep. No. 494, 83d Cong., 1st Sess. 6. Thus, under the statutory scheme participations are preferred to 100% Government loans in order to insure that private loan aid is enlisted to whatever extent it is available.

(*a*). In view of the statutory mandate, most of the business loans advanced by the S.B.A. have been, and will continue to be, made in participation with a private lending institution. As of October 31, 1959, 64.3% of the business loans approved by the S.B.A.

[10] When participation is immediate (as in this case), the S.B.A. pays the bank the amount by which it has obligated itself simultaneously with the bank's advancing the loan funds to the borrower. In a deferred participation, the S.B.A. makes disbursement at a later date, but only if and when the bank so requests. Since the distinction between the two types of participation is only with respect to the time when the Government funds are advanced, it is not relevant for our purposes. Both immediate and deferred participation agreements contain a clause providing for the pro rata sharing of gains and losses on the loan transaction.

had been of the participation type, totalling $446,302,000.[11] On that same date, the S.B.A. had 7,201 participation loans outstanding, in which the S.B.A.'s participation amounted to $216,410,000. In addition to business loans, the S.B.A. is also empowered to make, either directly or in participation, disaster loans which it determines to be necessary or appropriate because of floods or other catastrophes. Sec. 207(b), 67 Stat. 236; 15 U.S.C. 636(b). Some 11.5% of such loans have been made in participation (the statute does not prescribe a preference for participation loans in this regard), and the S.B.A.'s interest in such disaster participation loans outstanding on October 31, 1959, was $7,353,000.

Since the provision relating to the sharing of profits and losses is in all the currently outstanding participation agreements of the S.B.A., the rule enunciated by the court below would have the effect of denying the S.B.A. a right to priority with respect to the $223,763,000 to which it has currently committed itself in participation loans. And the question of priority is of particular significance, since S.B.A. business loans, because of statutory prerequisites as to their availability, are primarily extended to concerns whose insolvency is not unlikely. Thus, the risk of loss by the Government on this sum of $223,763,000 is indeed substantial.

(*b*). As for all of its future loans, the only practicable way for the S.B.A. to avoid the impact of the

[11] This statistical information, as well as the other detailed information concerning the activities of the Small Business Administration contained in this petition, was furnished by the General Counsel's Office of the S.B.A.

decision below would be for it to revise its participation agreement forms so as to include a provision declaring that the participating bank will not be entitled to share in any recovery obtained by the S.B.A. by reason of its right to priority. Such an arrangement would be highly unattractive to prospective bank participants—on whose willingness to take part the success or failure of a participation program wholly depends. The possibility of being indemnified, at least in part, by the United States, which is more likely to collect its debts because of its right of priority, provides a strong incentive for banks to participate in the S.B.A.'s program. Furthermore, the banks would be often unable to share in the recovery of the S.B.A., while forced to divide their collections with the S.B.A. Thus, the Small Business Administration, in response to an inquiry as to whether modification of its participation agreements would be feasible, has replied: [12]

> * * * the inclusion of such a provision would, in our opinion, substantially defeat the purposes of the bank participation program. It is unlikely that many lending institutions would be willing to participate in a loan, or make a loan in participation with this Agency, if the lending institution was obligated to share with this Agency any and all collections it made, but this Agency was not obligated to share with the lending institution any collections it received by reason of its right to priority of payment. * * *

[12] Letter of December 10, 1959, to the Department of Justice, from the Small Business Administration.

The decision below thus poses for the S.B.A. the dilemma of having either to lose its right of priority with respect to all its future participation loans, or else to amend its participation arrangement, and thereby risk frustration and failure of the participation lending program which Congress has prescribed for aiding the small businessman.

(*c*). The decision below may produce other undesirable and far-reaching consequences. Since it, in effect, denies the S.B.A. a right of priority on all sums advanced by it under its present participation program, the ruling of the Tenth Circuit may well have the effect of making a small business's creditors eager to push the business into bankruptcy immediately after it receives an S.B.A. participation loan in order to reap a benefit from the loan funds. On that basis, instead of aiding and encouraging the continued operation of a small business, the S.B.A. loan would hasten its demise. On the other hand, if the S.B.A. were allowed priority on its advances, creditors would have nothing to gain from an immediate bankruptcy, and the loan's purpose—to stimulate confidence in the business and to enable it to continue functioning—would more likely be served. Similarly, under the Tenth Circuit's view, creditors will be tempted to induce small businesses to obtain S.B.A. participation loans merely for the creditors' benefit in the event of bankruptcy. Such a purpose in securing a loan would not fulfill any of the objectives of the Act and, indeed,

is contrary to the S.B.A.'s regulations. 13 C.F.R. 120.4–2(d)(1)(i).[13]

3. Soon after the outbreak of the Korean conflict, Congress enacted the Defense Production Act of 1950, 64 Stat. 798, 50 U.S.C. App. 2061, to provide, *inter alia*, a wide variety of incentives to increase productive capacity and the supply of materials and services needed for defense. Section 301 of the Act empowered the President to authorize various procurement agencies of the United States to guarantee loans made by public or private financing institutions, "for the purpose of financing any contractor, subcontractor, or other person in connection with the performance of any contract or other operation deemed by the guaranteeing agency to be necessary to expedite production and deliveries or services under Government contracts for the procurement of materials or the performance of services for the national defense." 64 Stat. 800, as amended, 50 U.S.C. App. 2091(a).[14] The agencies so

[13] Furthermore, in many situations it will be obviously unjust to deny the S.B.A. priority on its debt claim in bankruptcy because the proceeds of the S.B.A.'s loan funds will comprise the bulk of the bankruptcy. S.B.A. participation loans, by necessity, go to small businesses that are not wholly prosperous and that cannot get credit from other sources. When such a business goes into bankruptcy, its remaining funds will often be traceable to the S.B.A. loan. Thus, it is hardly a coincidence that, in the case at bar, a $20,000 participation loan was extended, and $19,000 is the amount in the trustee's hands—particularly since the involuntary petition in bankruptcy was filed less than a year after the loan was made.

[14] Under the 1953 amendment to the Act, such loans may also be guaranteed in connection with the termination, in the Government's interest, of defense contracts, and small businesses are made eligible for guaranteed loans despite the availability of alternative sources of supply. 67 Stat. 129, 50 U.S.C. App. 2091(a).

amed have been the Departments of the Army, Navy, nd Air Force, the Atomic Energy Commission, the eneral Services Administration, and the Depart-ents of Commerce, Interior, and Agriculture. E.O. 480, 18 F.R. 4939.

Under this program, known as the "V-loan" pro-ram, a defense contractor first approaches a private nk, and the bank then asks one of the above-named overnment agencies to guarantee the loan in whole in part. If the agency approves the loan, the Fed-al Reserve Bank, acting as fiscal agent of the gency, will enter into the guarantee agreement with e lender.[15] . This agreement between the private stitution and the Federal Reserve Bank is really ne of deferred participation by the United States, ther than of guarantee, because the standard V-loan greement provides that the Government agency is bligated to purchase a stated percentage of the loan demand of the lending bank, and that all collec-ons and losses on the loan are to be shared ratably tween the bank and the Government agency.[16] nce, therefore, the V-loan program is, in all rele-nt respects, similar to the S.B.A. participation rogram, the adverse effect of the decision below ould apply to it with equal force.

From the inception of the V-loan program in 1950, rough April 1958, the Government agencies admin-

[15] See *Report of the Attorney General Pursuant to Section 8(e) of the Defense Production Act of 1950, as amended*, ugust 8, 1958, pp. 18–21.

[16] "Section 301 of the Act, 64 Stat. 800, 50 U.S.C. App. 91(a), suggests that V-loan guarantees be accomplished by greement to share losses * * *."

istering the V-loan program have guaranteed in the above manner $2.4 billion in loans. *Report of the Attorney General, supra,* p. 28. As of December 31, 1959, ninety-five V-loans were outstanding.[17] Of these, in only five does the Government guarantee extend to 100%. The Government's interest in the remaining ninety loans—in all of which the guarantee agreements provide for the sharing of gains and losses—is $252,000,000.

With regard to the future, amendment of the V-loan agreement would carry with it much the same objections as those presented above with reference to modification of the S.B.A. participation program. In this connection, Mr. Merritt Sherman, Secretary of the Board of Governors of the Federal Reserve System, states:[18]

> The present V-loan program, like the similar wartime program, is designed to encourage participation by private financing institutions in the making of loans to contractors engaged in production or services deemed necessary for the national defense, especially where, because of ordinary credit rules, such financing would

[17] In addition, Section 302 of the Defense Production Act of 1950, 64 Stat. 801, 50 U.S.C. App. 2092, empowers the President to make provision for loans, including participations, to business enterprises to aid defense production. In making loans pursuant to this section, the Treasury Department has favored participation loans rather than direct loans. *Report of the Attorney General, supra,* pp. 14–15. Since the participation agreements in this program also provide for the sharing of gains and losses, this program would also be directly and adversely affected by the decision below.

[18] Letter of January 20, 1960, to the Department of Justice from the Board of Governors of the Federal Reserve System.

not be forthcoming without a certain degree of Government protection. Consequently, the agreement of the guaranteeing Government agency to share losses according to the respective interests of the guaranteeing agency and the financing institution has constituted an essential element of the V-loan program since its inception in 1942.

4. In sum, Congress and the Executive have viewed the joint participation of private lending firms and Government agencies in lending programs as an appropriate and desirable method of encouraging business concerns which, in the absence of Government participation, would be unable to borrow capital. In particular, the participation loan program administered by the Small Business Administration was devised by Congress as an effective means to sustain the small business concerns regarded by it as essential to the economic well-being of the Nation. The V-loan program, similarly, was devised to assure that defense production would not be impeded because of an unavailability of capital. The erroneous decision below, if allowed to stand, will seriously undermine these participation programs by forcing the administering agencies to alter them and thereby risk their impairment, or else to forego the right of priority accorded by statute to debts owing the United States. And even if the participation programs were to be amended, the view taken by the Tenth Circuit would result in the denial to the United States of a right of priority with respect to the almost half billion dollars in government participations currently outstanding.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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FEBRUARY 1960.

APPENDIX

United States Court of Appeals for the Tenth Circuit

No. 6117—September Term, 1959

SMALL BUSINESS ADMINISTRATION, APPELLANT,

v.

G. M. MCCLELLAN, TRUSTEE, APPELLEE.

Appeal from the United States District Court for the District of Kansas.

In the matter of S. H. Byquist, an individual, doing business as Western Distributors, Bankrupt.

Morton Hollander, Attorney, Department of Justice (George Cochran Doub, Assistant Attorney General, Wilbur G. Leonard, United States Attorney, and Samuel D. Slade and Peter H. Schiff, Attorneys, Department of Justice, were on the brief) for Appellant.

John Q. Royce for Appellee.

Before BRATTON, LEWIS and BREITENSTEIN, Circuit Judges.

BREITENSTEIN, Circuit Judge.

In this bankruptcy proceeding the court below affirmed a referee's order allowing a claim of Small Business Administration as an unsecured claim and denying it any priority. The only question on ap-

peal is the right to priority over other unsecured creditors.

The facts are not in dispute. Byquist, the bankrupt, applied on a Small Business Administration [1] form, entitled "Limited Loan Participation Application for Loan," to the Brookville State Bank of Brookville, Kansas, for a $20,000 loan. On October 30, 1956, the Bank endorsed the application to show that it was willing to make the loan upon the participation of SBA therein to the extent of 75%. SBA agreed and on November 19, 1956, entered into a "Participation Agreement" with the Bank. Therein it was provided that upon written demand by the Bank SBA would purchase a 75% interest; that the Bank would hold the note and on five days written demand would transfer it to SBA; that the holder of the note would service it and remit promptly to the other party its pro rata share; and that SBA and the Bank were to bear any loss incurred ratably according to their respective interests in the loan.

On November 21, 1956, SBA sent the Bank its check in the amount of $15,000 for the sole purpose of purchasing a 75% interest in the loan. The Bank then loaned $20,000 to Byquist who executed and delivered a note payable to the Bank and made out on an SBA form in which he agreed to use the loan proceeds solely for the purposes set out in the SBA loan authorization and to reimburse the "Holder" and SBA for expenses incurred by them in connection with the loan.

After the filing of an involuntary petition in bankruptcy, Byquist was adjudicated a bankrupt on September 5, 1957, and a trustee was duly appointed. The estate is valued at approximately $19,000 and the claims filed exceed $43,000.

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[1] Hereinafter referred to as SBA.

Subsequent to the date of bankruptcy, the Bank assigned the note to SBA which on October 15, 1957, filed a claim for the unpaid balance amounting to $16,788.42 and claimed priority therefor.

At the outset we have the contention of the trustee that SBA is not an agency of the United States and hence is not entitled to any priority given the United States. In view of the disposition which we make of this case it is not necessary to consider that point. For the purposes hereof we assume that the claim belongs to and is made by the United States subject only to its agreement to share the loan proceeds and losses ratably with the Bank.

The issue is whether, at the date of bankruptcy, there was a debt which was due the United States within the meaning of R.S. § 3466[2] and which was for that reason entitled to a priority under § 64(a)(5) of the Bankruptcy Act.[3]

The note was made payable to the Bank and was held by the Bank on the date of bankruptcy. In United States v. Marxen, 307 U.S. 200, it was determined that the United States was not entitled to priority on a claim based on a note which had been assigned after bankruptcy upon the payment by the Federal Housing Administrator of a loss under an insurance policy issued pursuant to the National Housing Act. This decision was followed in In re Miller, 2 Cir., 105 F. 2d 926–928, wherein it appeared that the bankrupt obligor had agreed to indemnify the United States for any loss it might sustain by

[2] 31 U.S.C. § 191, which provides in part that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor.

[3] 11 U.S.C. § 104(a)(5), which allows a fifth priority to "debts owing to any person, including the United States, who by the laws of the United States i[s] entitled to priority."

reason of its insurance of the credit. Basically, the rights of the United States in each case were those of a subrogee whereas here the United States participated in the loan. Such participation is said to result in beneficial ownership of a part of the debt on the date of bankruptcy and, hence, to render unimportant the fact of post-bankruptcy assignment.

On the facts of the case at bar we deem it unnecessary to decide whether the United States has any greater rights as a participant in a loan pursuant to the Small Business Act of 1953[4] than it had as a subrogee under an insurance policy issued by it under the National Housing Act. The claim of the United States rests on the premise that it is asserting a debt covered by § 3466 and recognized by § 64(a)(5) of the Bankruptcy Act. While § 3466 must be construed liberally to effectuate its purpose to protect the public finances,[5] the Court said in Marxen that:[6]

> * * * this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, and by legislative intention, as shown by other statutes.

In the Small Business Act of 1953, Congress declared the policy that the government should aid the interests of small business concerns "to preserve free competitive enterprise."[7] To attain that end the administrator of the act is empowered, among other things, to make loans to small business concerns either directly or "in cooperation with banks.

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[4] 15 U.S.C. §§ 631–647.

[5] *United States* v. *Emory*, 314 U.S. 423, 426. Cf. *United States* v. *Johnson*, 10 Cir., 87 F. 2d 155, 161.

[6] 307 U.S. 206.

[7] 15 U.S.C. § 631(a).

* * * through agreements to participate * * *."[8] Thus, the United States went to the financial aid of small business by the general extension of credit which otherwise would have been available only from private lending institutions. The United States entered upon a commercial venture which supplemented the activities of private business.

The argument is advanced that by so doing, the United States intended to forego the applicability of § 3466 because the assertion of the priority provided thereby would not benefit small business but would handicap it in its efforts to operate with private financing. The situation is said to be analogous to that considered in *United States* v. *Guaranty Trust Company of New York*, 280 U.S. 478, where debts incurred under the Transportation Act of 1920 were held to have no priority under § 3466, and distinguishable from *United States* v. *Emory*, 341 U.S. 423, where § 3466 was applied to certain transactions under the National Housing Act, the purpose of which was held to be not the strengthening of the general credit of property owners but the stimulation of the business trades. Here again the intriguing arguments presented need not be resolved.

The determining fact is that S.B.A. has by written contract with the Bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.

Marzen holds that absent controlling legislation, which is not present here, § 3466 grants priority only to the United States. In Nathanson v. National Labor Relations Board, 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a

[8] 15 U.S.C. § 636(a).

private party. This principle would be violated if the claim of the United States were here given priority.

The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by § 3466.

The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands.* The use of § 3466 to prefer the Bank over the other private creditors would defeat that intent.

The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under § 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

Affirmed.

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* *Kothe* v. *R. C. Taylor Trust*, 280 U.S. 224, 227.

JUDGMENT

Thirty-eighth Day, September Term, Friday, November 6th, 1959

Before Honorable SAM G. BRATTON, Honorable DAVID T. LEWIS and Honorable JEAN S. BREITENSTEIN, *Circuit Judges.*

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Kansas and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby affirmed.

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